

**DEPARTMENT OF HUMAN RESOURCE MANAGEMENT
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2000**



AUDIT SUMMARY

Our audit of the Department of Human Resource Management, including the Commonwealth Health Insurance Fund, for the year ended June 30, 2000, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no internal control matters that we consider material weaknesses; however, we include in our report the following reportable conditions:
 - the Department must improve purchasing procedures; and,
 - the Health Insurance Fund Chief Financial Officer must reconcile accounting records and prepare required year-end reports;
- no instances of noncompliance with applicable laws and regulations that are required to be reported under Government Auditing Standards.
- the current contingency reserve portion of the actuarially recommended reserve balance for the Health Insurance Fund is below the recommended amount. Management believes that it is not necessary to fully fund this portion and have implemented a plan to phase out the contingency reserve portion over time.

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October 28, 2000

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit and
Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Human Resource Management, including the Commonwealth's Health Insurance Fund**, for the year ended June 30, 2000. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope and Methodology

Our audit's primary objectives were to review the Department and Health Insurance Fund's accuracy of recording financial transactions on the Commonwealth's Accounting and Reporting System, adequacy of internal control, adequacy of reserve balances, and to determine compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations, over the significant cycles, classes of transactions, and account balances: accounts receivable, receipts and expenses, claims payable, and contract administration.

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

Management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide an opinion on internal control or on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of the internal control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth's Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal controls that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions are discussed in the sections entitled "Human Resource Management Highlights" and "Heath Insurance Fund Highlights." We believe that none of the reportable conditions is a material weakness.

The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

There were no audit findings reported in the prior year.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on February 16, 2001.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF HUMAN RESOURCE MANAGEMENT HIGHLIGHTS

The Department of Human Resource Management (Department) is responsible for the administration of the Commonwealth's personnel act and health insurance plans for state and local employees. The Department's responsibilities include providing expertise in the areas of compensation, equal employment compliance, health benefits, and human resources policy and training. The Department is also the Commonwealth's central source for information about the Commonwealth's employment work force and provides a listing of state employment opportunities. The Department has several offices: Compensation and Policy, Equal Employment Services, State and Local Health Benefits, Employee Information Systems, Combined Virginia Campaign, Human Resources/Business Engineering, and on July 1, 2000 the Department assumed responsibility for the Worker's Compensation Program.

The Department has undertaken several initiatives during the past year. In September 2000, they began implementing Compensation Reform with the objective of compensating state employees in a manner that is sufficient to recruit, retain, support, and develop a high performance work force. In another initiative, the Department is working to make personnel and benefit data available to state employees and decision makers via the Internet.

In fiscal year 2000, the Department received general fund appropriations of approximately \$6 million. The Department spent \$4.6 million for payroll costs for about 64 employees. The remaining \$1.4 million purchased equipment and supplies required to administer the daily operations of the Department and implement new initiatives.

Follow Commonwealth Procurement Procedures

The Department of General Services' Division of Purchases and Supply, performed a review of procurement management at the Department and cited several areas of non-compliance including failure to use competitive bidding, adhere to contract terms, and follow small purchase charge card guidelines. All agencies are required to follow the Commonwealth's Procurement Manual to ensure they obtain the best possible price and that the goods and services meet their needs. In response to the report, the Department is developing internal control procedures to comply with the Procurement Manual.

HEALTH INSURANCE FUND HIGHLIGHTS

The Commonwealth of Virginia offers state employees and retirees, as well as Virginia localities' employees, the opportunity to participate in a group healthcare program. The program consists of several self-insured plans and nine commercially-insured health maintenance organization (HMO) plans. The self-insured plans offered include Key Advantage, Cost Alliance, and Advantage 65, a Medicare supplement.

The Department manages all health insurance programs and uses contractors to perform most of the program operations. The Department's responsibility is to procure these contractors' services and oversee the contracts. They manage the programs through state agencies by developing instructions and training, and serving as a resource to agency benefits officers. Currently, the Department is developing premiums for fiscal year 2002.

Administration of the Commonwealth Self-Insured Plan

The Department has contracted with Trigon and Magellan Behavior Health, formerly GreenSpring Health Services, for the administration of the Key Advantage and Cost Alliance programs. Trigon administers the medical/surgical, dental, outpatient prescription drug and comprehensive case management programs. Magellan administers the mental health/substance abuse program. Trigon and Magellan receive and pay provider claims, verify participant eligibility against the state's Benefit Eligibility System (BES), and serve as liaisons with health care providers and hospitals. Trigon bills the Commonwealth weekly for all claims processed.

The contracts establish standards of performance for claims accuracy, processing time, and savings due to coordination of benefits with other insurance companies. The contracts require the measurement of performance standards through claims audits and impose monetary penalties for failure to meet the established standards.

The Department contracts with a consultant to monitor claims paid by Trigon. The consultant currently reviews claims for eligibility requirements and produces weekly exception reports. The Department reviews the exception reports and forwards improperly paid claims to Trigon for review and correction.

Reserves

The Commonwealth assumes all risk for the self-insured health insurance program provided to state employees and retirees. If the Health Insurance Fund (Fund) had a deficit, the Commonwealth would have responsibility for paying the outstanding claims. Annually an actuary reviews the Fund and recommends reserves consisting of three components: incurred but not reported (IBNR), extended benefits, and contingency. The IBNR portion of the reserves is based on historical data and represents the amount of claims that the Health Insurance Fund can expect to pay subsequent to fiscal year end. The extended benefits portion differs from the IBNR in that it represents potential claims that are outside the norm. The contingency reserves represent the amount of money the Commonwealth would need to pay the administrative costs of closing out the Health Insurance Fund as well as any outstanding claims.

IBNR and extended benefits actuary amounts totaling \$57.9 million for fiscal year 2000 were accrued by the Department and are fully funded. Management believes that it is no longer necessary to fully fund the contingency reserve portion of the actuarially recommended amount. Therefore they have implemented a plan to phase out the contingency reserve portion over time. For fiscal year 2000, the actuary recommended a contingency reserve of \$36,497,714, of which \$35,226,669 was fully funded.

In fiscal year 1999, the Health Insurance Fund received appropriations of \$19.2 million in reserve funds that can not be obligated or expended without approval from both the Secretaries of Finance and Administration. In fiscal year 2000, the Department spent \$8.7 million of the reserve funds to cover expenses and claims obligations.

Premium rates were increased July 1, 1998 and January 1, 1999 for all self-insured plans for active employees and all retiree plans. Premium rates increased again for all self-insured plans for active employees on July 1, 2000. Despite the premium increases, the Fund had an operating loss in fiscal year 2000 due in part to members using their benefits in anticipation of benefits changes that went into effect on July 1, 2000. The Department has worked with the Department of Planning and Budget to set fiscal year 2002 premium rates

and increase the outpatient hospital co-payment to establish adequate funding in the future. However, we project operating losses will continue next year and the excess contingency reserves will be adequate to offset the losses.

Accounting Functions

In prior years, the Department of Accounts (DOA) performed all of the accounting functions for the Health Insurance Fund. Management moved the accounting functions in-house during fiscal year 2000 and had the newly created position of Chief Financial Officer (CFO) perform this work. The Department hired a CFO in September 1999, who left in April 2000. Just before year-end, the Department filled the position again, however, the individual did not receive training in the state's monthly and fiscal year-end procedures.

As a result, the CFO did not comply with the DOA deadline for preparing year-end financial statements and attachments. Further, he did not reconcile financial records as required by state accounting policies. The Department should require the CFO to receive all necessary training to understand and comply with the state's accounting and reporting requirements.

DEPARTMENT OF HUMAN RESOURCE MANAGEMENT
Richmond, Virginia

Sara Redding Wilson, Director – Department of Human Resource Management

A.C. Graziano, Director – Office of Health Benefits